



CITY OF FALLS CHURCH

October 5, 2009

TO: City Council

FROM: John Tuohy
Chief Financial Officer

SUBJECT: FY2009 fourth quarter report of financial condition

Attached is an unaudited statement of revenues, expenses and changes in fund balance for the General Fund (budget to actual) for FY 2009 through June 30, 2009. The activity reflected in the attached statement is for the fiscal year with substantially all accruals posted. The statements are not prepared using audited numbers; therefore the final financial report for the City may be slightly different from this preliminary report.

Revenues for FY2009 were approximately \$7 million below projections. This is a negative budget variance of approximately 10%. Sales tax and real estate tax together account for \$5.2 million of this amount.

Overall expenditures came in \$2.9 million below budget. This is a positive budget variance of slightly over 4%.

The City's fund balance will decline to approximately \$4.3 million. Of the remaining fund balance, approximately \$1.4 million is reserved for various commitments at year end. This will result in an unreserved fund balance of 4.7%. The fund balance is \$2.038 million below the amount needed to meet the minimum policy requirement of 8% of revenues.

An action plan for bringing the fund balance to the amount set by Council policy and to address implications for the current fiscal year will be provided in a separate document on October 5.

Revenues

Real estate tax revenues were below budget by \$2.7 million. A portion of this was identified early in FY2009, leading to the City Manager's proposal to severely restrict expenditures. In addition, the methodology adopted for estimating revenues resulted in a negative variance between budget and actual larger than anticipated.

Sales taxes were \$2.6 million below projections. The majority of the shortfall, approximately 80%, is attributable to a correction made by the State's department of taxation for businesses located in Fairfax County that had been listed as located in the City. The State made the

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correction for the current fiscal year and three prior years all in FY2009. Some portion of the decline was also attributable to general economic conditions.

The significant elements of the City's General Fund results for FY 2009 may be subdivided into non-recurring and recurring. The recurring items affected the development of the FY2010 budget and will be considerations in developing FY2011. The non-recurring items indirectly affect future years through the lower than expected FY2009 ending fund balance.

Non-recurring items include:

- The retroactive corrections made by the Virginia Department of Taxation for FY2008, 2007 and 2006. This resulted in a non-recurring decline in receipts of \$1.4 million.
- Permit revenue for FY2009 was predicated on the City Center and Northgate projects moving forward. These revenues were reduced by almost \$600,000 in compiling the FY2010 estimates.

The recurring items that affect FY2010 and will be factors in developing the FY2011 budget include:

- Real estate Assessments declined in FY2009 and will decline to a far greater degree than was anticipated in developing the FY2010 budget. Although single family dwellings appear to have nearly stabilized in value, commercial properties throughout the region are declining at double-digit rates and we expect a similar experience here in the City. Distressed sales of condominiums are out of proportion to their share of the City's housing stock, which will result in a continued decline in residential assessments. However, this decline will not be spread equally among the various condo developments. Although further declines of the magnitude likely during the next assessment cycle are considered unlikely, it is virtually certain there will not be a significant recovery of value either. In addition to the decline in value described above, the \$2.7 forecasting shortfall will carry forward into FY2010.
- The sales tax corrections referenced above, when added to revised downward projections based on recent receipts, result in a permanent decline in receipts, of approximately \$1 million. This is on top of the decline of 15% projected during the development of the FY2010 budget resulting from general economic conditions. Even when BJ's is fully operational, total sales tax receipts will remain at depressed levels for the foreseeable future.
- The red light camera program did not begin operation during FY2009. This resulted in \$427,000 in unrealized revenues. This was partially offset by the City not incurring most of the costs associated with the program.

Expenditures

Expenditures for the year were below projections. This is attributable both to a greater emphasis on holding off on expenditures due to the known budget difficulties and due to explicit cost containment measures.

- Turnover in positions resulted in vacancy savings of approximately \$570,000.

- Programmed budgetary adjustments adopted mid-year resulted in approximately \$800,000 in savings. Many of these adjustments were carried forward in preparing the FY2010 budget.
- Federal funded grant expenditures were \$400,000 below budget. This also resulted in federal revenues being below by the same amount.
- As a result of not implementing the red light camera program, the cost was \$357,000 below budget. As noted above, this also resulted in a negative variance in revenues.

General Observations

This report is intended to provide analysis of FY2009, however there are a number of elements of the year's activity that have implications going forward to FY2010, FY2011 and beyond.

- The decline in real estate assessments is expected to level off during the next calendar year, though it may not have fully reached bottom. Prior recessionary experience in Northern Virginia indicates that once the market reaches a low point, it takes five to seven years to enter another cycle of increasing values.
- Once the BJ's construction is complete, it is unlikely that there will be any significant construction activity in the City for the upcoming year. This will result in very low income from permit fees as well as a decline in contractors' BPOL receipts.
- The red light camera program did not begin operation during FY2009 and has not been implemented at this time. Although it is anticipated to begin operation during FY2010, it will be very late in the year before any revenues will be received. The full amount of start-up expenses will be recognized during FY2010 without the full amount of offsetting income. If the program does not begin until the fourth quarter of FY2010, there will be a negative effect on FY2011 revenues, as well.
- Continuing steep declines in state revenues have resulted in reductions in aid to localities, including the Registrar, Courts, Police, Library and Constitutional officers. Reductions proposed for the current fiscal year come on top of cuts already implemented. Reduced support from the Commonwealth in FY2010 will become the new base for revenues in FY2011.
- This report does not reference issues being faced by the school division. The schools, however, are not immune to the effects of the economy, variations in state and federal funding, enrollment growth and upward pressure on the expenditure side.
- Both the general government and the school division will experience increased costs associated with employee pensions and health care (including retiree health) for FY2011 and in all probability for several years thereafter. This is the result of predicted increases in health care costs and the need to replenish the trust funds due to recent investment losses.

Utility Funds

Also attached is an unaudited statement of revenues, expenses and changes in net assets for the Water and Sewer funds. The major items affecting the City's Water fund during FY 2009 were:

- Average sales are 15 million gallons per day; weather this year was about normal for this area; therefore sales are close to the norm. Total sales are up 1% from FY2008.

- The Town of Vienna began to purchase all their water from the City beginning in the last quarter of FY2008, therefore an entire year's revenue is included for FY2009. Previously their purchases amounted to approximately half their needs. Vienna purchases water at a wholesale rate which is lower than the retail rate.
- Availability fees for FY 2009 were higher than FY2008. These fees vary greatly, depending on the nature and pace of development in the service area. The fees were \$1.5 million in for FY2009. They were \$763,000 for FY08, \$3.12 million in FY07, \$800,000 in FY 2006 and \$2.8 million in FY 2005. Availability fees are collected to offset certain capital expenditures related to the expansion of system capacity and, therefore, do not affect the net operating position of the system.
- Expenses related to the Fairfax Water lawsuit are divided between FY2009 and FY2010. The amount recognized in FY2009 is approximately \$1 million.
- Taken together, the system added an additional \$746,000 to net assets.

The water fund is financially stable over the near term. The Public Utilities Commission has recommended the City undertake a utility rate study. It is considered a best practice to conduct such studies periodically. The last such study was produced in 2002.